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OFFICE OF  
CHIEF COUNSEL

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CC:TEGE:B2

Dear :

I apologize for the delay in responding to your letter of July 15, 2002, on behalf of your constituent, of Tennessee. In general, is concerned about the affect the recent Supreme Court's ruling in *United States v. Fior D'Italia, Inc.*, 122 S. Ct. 2117 (2002) will have on small companies in the hospitality industry. He recommends the Congress enact legislation to reduce employer's liabilities.

Employers must pay FICA taxes on wages and tips including unreported tips, which are wages for FICA purposes. [Section 3121(q) of the Internal Revenue Code (the Code)]. Employees must report their tips to their employer, who then forwards the statements to the IRS and pays the employer's portion of the FICA tax. If the employee does not provide a statement of tips (or the statement is incomplete or inaccurate) the wages are deemed paid on the date which notice and demand for such taxes is made to the employer, by the IRS. The employer must also report the amount of tips paid on credit cards.

In 1991 and 1992, Fior D'Italia paid FICA taxes based on tips reported by their employees. Fior D'Italia also reported the tips on customer credit card receipts, which far exceeded the amounts the employees reported. Because of the discrepancy, the IRS did a compliance check that led to an assessment of additional FICA taxes due from Fior D'Italia. The IRS made the assessment using the "aggregate estimation" method to calculate the average percentage tip on credit card receipts and applied it to the cash sales. The IRS then added the estimated cash tips to the actual credit card tips to determine the estimated total tips received during 1991 and 1992. Finally, the IRS subtracted the amounts employees previously reported from the estimated total tips and assessed the additional FICA taxes owed. The Supreme Court held that the IRS was within its rights to assess the additional FICA taxes based on the "aggregate estimation" of tips.

seems to have two main concerns with the Supreme Court's decision in *Fior D'Italia*:

1. The employer was assessed FICA taxes on cash tips the employees failed to report to the employer.
2. Holding an employer liable for FICA taxes on cash tips the employees failed to report allows the IRS to use an employer as an "enforcer."

An employer's liability for FICA taxes on wages earned by employees does not depend on whether employees report tips to their employer, under section 3121(q) of the Code. The IRS has the authority to assess taxes that have not been duly paid. [Section 6201(a) of the Code]. Courts have consistently held that the IRS may estimate tax liability if the estimation is reasonably based. *Fior D'Italia* stipulated that it would not challenge the IRS's estimation of cash tips. The Supreme Court stated, "Absent such a stipulation, a taxpayer would remain free to present evidence that an assessment is inaccurate.... And we do not accept *Fior D'Italia* claim that restaurants are unable to do so...." The Court gave several ways restaurants could refute an IRS assessment. Thus, an employer can dispute an IRS assessment of tips.

The Congress has limited an employer's liability for unreported cash tips. An employer's liability on tip wages was effectively reduced by section 45B of the Code because it limited the employer's FICA tax to the amount that would be due if the employee received only the minimum wage, no matter how much the employee actually earned. In addition, most employers (outside the hospitality industry) are generally liable for both the employee and the employer's FICA taxes on wages up to the FICA wage base, if they are not paid.

I forwarded suggestion for legislative action to the office of Tax Policy at the Treasury Department. We will make this letter available for public inspection after we delete names, addresses, and other identifying information, as appropriate, under the Freedom of Information Act.

I hope this information is helpful. If you or have additional questions or if we may assist you further, please call me at

Sincerely,

Lynne Camillo  
Branch Chief, Employment Tax Branch 2  
Office of Assistant Chief Counsel  
(Exempt Organizations / Employment Tax /  
Governmental Entities)